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Rethinking the Role of Government in Agri-Food Markets

Julie A. Caswell

The year 1996 marked the fiftieth anniversary of the Agricultural Marketing Act of 1946, a sweeping piece of legislation that forms a major underpinning for government activities to promote agricultural marketing in the United States. Beyond that law, much of domestic food and agricultural marketing policy and many of our institutions date back even further to the 1920s and 1930s and have been recently viewed as outmoded to various degrees by different people. What set of government marketing policies fits the current and future agri-food system and is in the public interest? The question is one of optimal policy design, if such a thing can be defined effectively.

Identifying the set of marketing policies that fits current and future conditions is a formidable task, requiring consideration of how markets are operating and how they are likely to change in the future. The most difficult aspect of the task, however, is considering what are the performance standards to which we wish to hold the agri-food system, to what degree is some notion of fairness part of those standards, and, if fairness is important, what standard of fairness should we use?

Valuable treatises have been written on these subjects. However, I propose to talk about them more informally. In a session on marketing orders at the 1994 meeting of the Food and Agricultural Marketing Consortium, Gary Fairchild posed the questions in this form: "If we did not have marketing orders today, would we want them, propose them? Could we get them approved?" The second question is especially timely since the relative size of the agricultural sector is now smaller than when the programs were originally passed, and rationales for policies have evolved as well (Gardner).

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Major Marketing Policies in Agri-Food Markets

There is no definitive list of marketing policies for the agri-food system since marketing can be defined broadly or narrowly depending on the purpose and focus of the analysis. For our purposes I have chosen a broad definition to include most policies that attempt to affect the price, quality, and disposition of agricultural products as they leave the farm and move through the food processing and distribution system to ultimate consumers. The list of major policy levers includes

1. Price, situation, and outlook reports; other informational programs.
2. Marketing orders.
3. Grades, standards, and inspection services.
4. Domestic and foreign advertising, promotion, and market development.
5. Authorization and facilitation of cooperatives.
6. Trade practice regulation.
7. Antitrust policy.
8. Food safety and nutrition regulation.
9. Facilitation of research, particularly at USDA and land grant universities.

Marketing policies operate in the context of broader sets of policies government uses to support (Congressional Budget Office) or limit business. These include policies on price/income supports to agriculture, taxes, credit availability and cost, and international trade.

Is the Agri-Food Sector Special (Different)?

The bedrock issue to consider in rethinking the role of government in the future agri-food system in all policy areas, including marketing policy, is whether the agricultural, food processing, and food distribution sector is now, compared to the past, special or different in important respects from other sectors of the economy. If it is, it may require or merit public

policies different from those used in the general economy. If not, it does not.

My premise is that the agri-food system is not now generally special or different in meaningful ways that suggest the need for specialized marketing policy. This premise rests on three arguments. First, farming as a business is not unique from many other small, medium, and large businesses run by individuals and corporations. While family farm values are real, family farming in its nostalgic form has largely faded. Nor are food processing and distribution industries unique in their characteristics. This does not imply that farmers, for example, do not face challenging and often difficult circumstances in making a living from their occupation. It simply says that a farmer faced with loss of market or tough competitive circumstances is not different from a textile manufacturer, restaurant owner, or service worker faced with a similarly tough situation. Either both or neither should be the focus of policy attention.

Second, agricultural and food markets are in most cases mature enough to operate without a great deal of public support and policy input, especially when it is at significant variance with that experienced in other industries (Congressional Budget Office, Offutt). For example, the notion of orderly marketing of food products is not without merit, but do we worry to the same extent about the orderly marketing of steel, televisions, or clothes? Every season, clothing stores mount big sales to dispose of stock that must only be the result of disorderly marketing of one kind or another. But we largely rely on markets to smooth out this disorderliness and do not view it as a government responsibility to assure that clothing stores earn a fair return on their investments.

A third, related point is that agricultural and food products are obviously critically important as a necessity of human life. This special status does not, however, warrant special policies to control or influence demand and supply, although it does call for public policy to monitor and regulate some quality attributes such as safety. The United States can rely on its agricultural resource blessings and ability to buy on the world market to assure adequate supplies at affordable prices.

Least I be misunderstood at this juncture, the above arguments are not in any way equivalent to a "markets always work perfectly" view of the world. What they say is that agricultural and food markets are not fundamentally different from other markets that require varying levels of regulation, monitoring, and facilitation in

a free-market economy. This is not equivalent to arguing for unregulated agri-food markets since the United States uses a broad array of policies to alter the operation of markets in all industries. It is arguing for comparable levels of intervention. For example, fairness in a market may not require a price support but may require some government specification of marketing institutions that seek to ensure a fair bargaining environment.

Market Failure Paradigm and Its Limitations

Government's role in the economy has been under intense scrutiny in recent years. Familiar arguments center around the weight of regulatory burdens, the scope of regulation, and whether certain policies are forms of corporate welfare. The government's role is ultimately judged based on the social and political consequences of its actions. There is also a continuing trend toward increased use of economic concepts and constructs in the evaluation process. In the first instance this involves a trend toward subjecting government policies and regulations to more consistent, stringent, and demanding benefit-cost tests (see, e.g., Belzer and Theroux).

In the second instance, there is a trend toward a public policy philosophy of applying what I will call a "strict market failure test" to evaluating government's role in markets. Here market failures stem from the existence of externalities, public goods, and common property resources. Under this approach, the government's role in markets is constrained to instances where there are bona fide market failures and it is reasonably certain that government action in the market will result in improved performance over the market with market failure and no government role. What the strict market failure test ignores is a potential role for government in addressing market imperfections such as market power and inadequate information. What it also ignores is that the test is not generally applied across all government policies and its selective application makes for inconsistent policy.

Improved rationality in government policy can be pursued through use of consistent benefit-cost tests of policies intended to address cases of market failure, market imperfections, or undesired market outcomes. Applying benefit-cost criteria to marketing policy is often complicated because the policy is meant to influence markets that for the most part already exist, although with possible imperfections. In many cases "correcting" the imperfection im-

plies a redistribution of value (e.g., income) between the market participants. A further complication is that government may identify imperfections that it could lessen by offering a service on a fee basis (e.g., quality certification) that competes with potential private providers. Here judging the government role hinges on whether it has any special advantages (e.g., credibility, ability to control free riding, efficiency, competence) that argue for providing the service in competition with private providers.

What Performance for Which Beneficiaries?

What are the relevant performance dimensions for the agri-food marketing system? The tried and true economists' list with minor modifications works well. This list includes (i) efficiency, including allocative and technical efficiency; (ii) equity, including the impact of changes in the organization of the food system on producers, processors, and consumers; (iii) technical progress, including the impact of information systems on market performance; and (iv) availability of safe and nutritious food.

Discussions of the target beneficiaries of public policy in the agricultural and food industries tend to identify two groups. Consumers are nearly always identified as the beneficiaries in one way or another. Policies adopted must ultimately hinge on a rationale of improved food access, reliable supply, and/or lower prices. Farmers are the second, and some would argue the primary, target group of beneficiaries.

This focus needs modification. As argued above, farmers are not uniquely different from other large or small businesspeople. The ultimate performance criterion should be refocused on the well-being of consumers, with a secondary focus on the well-being of all market participants, including those working in farming, processing, and distribution. The agri-food system's claim to importance in the general economy is based on employment and sales in the entire vertical chain of distribution, but the target beneficiaries of agri-food programs are often limited to farmers and consumers. A broader focus would address this mismatch.

Marketing Policy in the Future

The current accepted wisdom (and reality) is that budget constraints, government downsizing, and shifts in regulatory philosophy will

continue to generate pressure to redefine the role of government in the agri-food system. This redefinition may have begun in earnest with the recent passage of the "Freedom to Farm" bill, although its ultimate impact is presently unclear (Offutt, Tweeton). In this context of changing price/income support policies, there are several important forces that are key to judging the desirability of continuing or altering particular marketing policies in the future. How these trends are being analyzed and interpreted to justify regulation, or the lack thereof, is also of interest.

Industrialization/Stronger Vertical Coordination/ Contractual Exchange/Globalization

The agri-food system is evolving to more closely resemble an industrialized system with consolidation of activity, more extensive reliance on contract production and vertical integration, and more international trade (Schertz and Daft, Drabentstott, Hurt, Boehlje and Schrader). This evolution poses challenges in both analyzing the size and importance of these trends and their implications for the role of government.

The most significant challenge industrialization poses for policy is analyzing its causes. One theme that runs through many discussions of industrialization of the agri-food industries is that industrialization is driven by forces at the consumer level, e.g., demand for food products with particular quality and price characteristics. I find this theme perplexing and largely unsupported. It implies that changes in horizontal and vertical market structure are dictated by consumer demand shifts that are minor in comparison to the shifts in market structure and organization. Market organization and structure are more determined by companies and their efforts to organize activities in a manner as profitable as possible, taking into consideration production and transaction costs, opportunities to create and use market power, and public policy.

A related blind spot in many discussions of industrialization is an overemphasis on the importance of transaction costs in determining organizational structure. It is as if after being overlooked for years, transactions costs are suddenly thought to be everything. They are clearly important, but are not everything. Understanding the nature of industrialization is crucial to assessing the role of government in the new, more industrialized agri-food system.

An analytical approach that ignores relative market power and overemphasizes the role of transaction costs has a built-in tendency to see current market outcomes as ideal.

Increased international trade and foreign direct investment in the agri-food system (Henderson, Handy, and Neff) also have an impact on the role of government policy. Trade agreements are increasingly guiding what is acceptable policy at the national level as they try to produce freer trade by circumscribing subsidies and nontariff barriers to trade. But it is also the case that trade agreements are a blunt instrument for exercising this type of control, and governments continue to have great latitude.

In terms of government's role, increased trade and foreign direct investment have an effect similar to that of the forces that have been labeled industrialization. They tend to diminish the role of government in price/income support programs and emphasize its role in designing and facilitating market institutions.

Shifts in Relative Market Power

A major traditional rationale for a government role in agricultural marketing is to address situations of unequal market power, particularly the perceived inferior bargaining power of farmers (Armbruster, Henderson, and Knutson, Padberg 1994, 1995). The existence of unequal bargaining power due to monopsonistic or oligopsonistic market structures remains a very contentious issue in agriculture. Its prevalence and importance are the subject of much recent analytical and empirical work (Peterson and Brooks, USDA Grain Inspection, Packers and Stockyards Administration; Rogers and Sexton), as well as federal task force efforts (USDA Agricultural Marketing Service).

The nature of this asymmetry in bargaining power differs in markets based on how much industrialization has occurred. Unequal bargaining power remains an issue in markets where industrialization has not taken place but the information environment remains richer in traditional market data. In markets where industrialization has occurred or is in process, the nature of the bargaining problem has shifted. Contracts typically specify multiple process or product attributes in addition to price, making effective public reporting and monitoring difficult. The potential is evident for processing companies to exploit their stronger market position when facing producers with large fixed investments. It is important to note, however,

returning to the question of whether agriculture is special or different, that situations of unequal bargaining power exist in many industries where suppliers are captive to major buyers whose decisions influence their survival. If the similarities between agriculture and other industries in this respect outweigh the differences, then policies to address bargaining asymmetries should be symmetric as well. If this is not the case, agriculture may merit unique marketing policies.

Information Availability

Information is generally becoming more easily accessible, with private services and web sites proliferating. However, significant information problems remain, for example, a lack of information on contract terms. Using Petzel's breakdown, government information-related activities in markets above the consumer level can be classified as (i) information that is publicly collected and paid for and (ii) information that is publicly collected and privately paid for (on a fee-for-service basis). In recent years, the former type of data has been decreasing in availability as the federal government has cut many programs. Of increasing importance as a public policy issue is a third type of information not delineated by Petzel: privately collected data that is sold to private users but may not be available for public uses. Such data from private information services can be very useful for policy analysis but the services often refuse to sell it to public users.

The central issue that information poses for federal marketing policy is the amount and form of marketing information that should be acquired and disseminated. This choice becomes more important as (or if) the government withdraws from more traditional agricultural programs because information provision may be the most effective way to monitor and influence the operation of markets at a relatively low cost.

Role of Government in Agri-Food Markets

Using a broad brush, my assessment of the role of government marketing policies in the future agri-food system is summarized below. This assessment is based on the arguments that the agri-food sector is not different from other sectors of the economy and should have a comparable level of government policy involvement; government policy should address market fail-

ures, market imperfections, and other undesired market outcomes; and consumers should be the primary beneficiary of policy, with producers, processors, and distributors being the secondary beneficiaries. Based on these arguments and trends in the agri-food system, my score sheet on government policies can be summed up as follows:

Programs to Phase Out

1. Marketing orders, with exception noted below.
2. Information programs that could be provided by private services or that do not support (a) governmental decision making or (b) fair operation of markets.
3. Advertising, promotion, and market development beyond cooperative efforts noted below.

Programs to Keep

1. Information programs that support (a) governmental decision making or (b) fair operation of markets. This includes programs to assure reasonable public access to privately collected data that is widely sold to private buyers.
2. Marketing orders that focus on assessments for research, advertising, and promotion.
3. Authorization and some facilitation of cooperatives and bargaining associations. The role of the government should be to provide opportunities for farmers and contract growers to band together, subject to the requirement that they are not able to exercise market power any more strongly than other market participants. In other words, economy-wide standards of antitrust violation should be applied. To justify policy asymmetry for agriculture (the same opportunities not being actively provided in other industries), credible arguments for differences in agriculture have to be made. Alternatively, the same opportunities could be offered to similarly situated participants in other industries.
4. Some trade practice regulation.
5. Antitrust policy.
6. Food safety and nutrition regulation.
7. Facilitation of research, although further downsizing may be warranted.

Programs to Offer on a Fee-for-Service Basis (Where Private Alternatives Are Inferior)

1. Grades, standards, and inspection services to

support them should be offered in competition with private services as long as there is a demand for the service (e.g., for grading services that the government is more credible in providing than private suppliers), fee revenue covers costs, and the government is technically able and has the resources to lead rather than lag developments in the market.

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